## INTEREST RATES ON FOREIGN OFFICIAL TIME DEPOSITS

June 30 (legislative day June 29), 1965.—Ordered to be printed

Mr. Robertson, from the Committee on Banking and Currency, submitted the following

### REPORT

[To accompany H.R. 5306]

The Committee on Banking and Currency, to whom was referred the bill (H.R. 5306) to continue the authority of domestic banks to pay interest on time deposits of foreign governments at rates differing from those applicable to domestic depositors, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

#### PURPOSE OF LEGISLATION

The bill, as amended, would extend through October 15, 1968, the authority for commercial banks to pay on certain foreign time deposits higher rates of interest than those otherwise permitted by regulations issued by the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation. This authority would be confined to time deposits of foreign governments, central banks, or other monetary authorities and international financial institutions of which the United States is a member. The present law, enacted October 15, 1962, provides an exemption from the interest rate ceilings on such deposits for a period of 3 years after that date. Without the extension of this authority, under paragraph 14 of section 19 of the Federal Reserve Act (12 U.S.C. 371b), and subsection (g) of section 18 of the Federal Deposit Insurance Act (12 U.S.C. 1828(g)), domestic banks would be limited in the payment of interest on foreign official time deposits to the ceiling rates applied to other time deposits.

This legislation and the existing law are parts of the U.S. Government's continuing and strengthened program to improve the international balance-of-payments position of the United States. As recommended by the Secretary of the Treasury, the authority originally granted for a 3-year period would be made permanent. H.R. 5306, as passed by the House of Representatives, however, would be

limited to a 3-year extension, and the Senate committee concurs in this limitation.

In recommending the legislation proposed, the Honorable Douglas Dillon, the then Secretary of the Treasury, sent to the President of the Senate a letter which was received February 17, 1965, and which set forth the following reasons for the legislation:

The proposed legislation would make permanent the temporary authority granted for a 3-year period by Public Law 87–827, approved October 15, 1962, for member banks of the Federal Reserve System, and banks insured by the Federal Deposit Insurance Corporation, to pay rates of interest on time deposits of foreign governments and monetary authorities without limitation by regulatory ceilings

applicable to time deposits generally.

During the period of time since the law became effective, U.S. commercial banks have been enabled to compete more effectively in providing an attractive investment outlet for the dollar holdings of foreign official agencies. The volume of time deposits of foreign official agencies increased by \$1,777 million from September 30, 1962, just prior to enactment of the law, through December 1964, when the total amounted to \$3,830 million. While no one can estimate with certainty what the volume of foreign official deposits would have been had our commercial banks not been provided authority to pay competitive rates beyond the ceilings applicable to other depositors, it is clear that a significant volume of foreign official funds have been attracted into this investment outlet by this form of bank competition. The result has been to help prevent the conversion of dollars into foreign currencies for investment in other markets and to provide an attractive investment opportunity as an alternative to the conversion of these dollar holdings into gold.

Consequently, the law has helped to protect the gold stock of this country and to enhance the attractiveness of our currency to foreign official institutions, supporting the key role of the dollar in the international financial system. At the same time, there is no evidence that this has had any adverse implications for our banking system. Competition for these deposits is generally confined to the larger and stronger commercial banks. Moreover, the amounts of funds available for such deposits, while highly significant in terms of international flow of funds, are limited relative to the overall deposit structure of our banks and the domestic money

market.

Thus for some time the authority granted under Public Law 87–827 has been used effectively, accomplishing highly useful results without adverse side effects. On the basis of this experience, and recognizing that these benefits should continue to accrue, the proposed legislation will make a valuable contribution to our continuing effort to reduce and eliminate our gold losses and maintain the strength of the dollar.

It is also important that the proposed legislation be enacted as soon as possible. While existing authority to pay a

higher rate of interest does not expire until October 15, 1965, banks are now effectively precluded from entering into deposit contracts that would require the payment of higher rates of interest after that date. Thus, time deposit contracts running beyond October 15, 1965, may no longer provide for the higher rates of interest for that period which extends beyond that date. Consequently, the benefits of the law have already been impaired for longer term time deposits, and is being steadily eroded for shorter maturies; for example, after April 15, 1965, banks will no longer be able to contract to pay the higher rate beyond 6 months in the future.

Longer term deposits are of particular importance. There are important instances where foreigners who borrow dollars in the United States for projects whose costs may be distributed over years in the future are interested, if interest rates are sufficiently attractive, in investing the proceeds of their borrowings in the United States until needed. It is with respect to this type of longer term deposit that the advantages of the legislation are greatest. At the present time because of the early expiration date beyond which higher rates may not be paid, these advantages are not available.

#### EFFECT OF LEGISTATION

The Honorable Frederick L. Deming, Under Secretary of Treasury for Monetary Affairs, in a subsequent letter addressed to Senator Proxmire, gave the following additional information as to developments under the existing legislation:

In connection with the specific data you requested \* \* \*, I am enclosing a table which compares the growth in foreign official time deposits with changes in investments in short and longer term U.S. Government securities. The data do not reveal any noticeable shift out of Government issues into time deposits because of higher than |ceiling rates. The volume of investment in the Government issues was little changed over the 18-month period between June 1963 and December 1964, while only the overall increase in foreign official dollar holdings was absorbed by time deposits. In the first quarter of this year, holdings of all types have declined with the decline registered primarily in Treasury bill holdings; but, in this period interest rates quoted for foreign official time deposits were fairly well below the ceiling, so that the effects of the legislative authority to pay higher rates was not brought into play.

Time deposits of monetary authorities are likely to be large and in practice the interest rate will be a matter of individual negotiation between the bank and the depositor \* \* \* and rates used in actual transactions would vary. It is quite likely, therefore, that in periods when the quoted rates were at or near the ceiling some transactions took place above the ceilings. The data are not collected on the basis of maturities so it is not known how much of the total of time deposits are held at the higher interest rates paid for the longer maturities or how much at the lower shorter term rates. The general practice of monetary authorities is, however, to keep their funds in fairly liquid form and it seems most likely that the large majority of deposits were in the more than 90-day but less than 6-month category on which interest during 1964 averaged about 3¾ percent. The fact that the differential between the quoted rates and the ceiling was at one time most pronounced in the less than 90-day deposits would not necessarily mean that any large volume of investment was made in that category.

Foreign official holdings of time deposits and U.S. Government securities
[In millions of dollars]

ef the honor lithit solut-	Time deposit	Treasury bills and certificates	U.S. Govern- ment bonds and notes	Total
1963: June 30. Sept. 30. Dec. 31. 1964:	3, 203 3, 313 3, 462	11, 917 11, 839 11, 569	2, 073 2, 301 2, 402	17, 193 17, 453 17, 433
March June September December 1965: March	3, 671 3, 899 4, 056 4, 104 4, 068	11, 015 11, 047 11, 503 11, 893 11, 059	2, 407 2, 310 2, 102 2, 028 1, 939	17, 093 17, 256 17, 661 18, 025 17, 066

#### LIMITATION ON AUTHORIZATION

The bill, as passed by the House and recommended by this committee, would limit the authority to a period ending October 15, 1968. This is in effect a limitation for a shorter period, because any time deposits received in the last 3 to 6 months before the termination date would be able to receive a higher rate only for a limited period, and longer term deposits would in effect be subject to the limitations that would be applicable to other time deposits.

#### CHANGES IN EXISTING LAW

In compliance with subsection (4) of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

# Fourteenth Paragraph (12 U.S.C. 371b) of Section 19 of the Federal Reserve Act

The Board of Governors of the Federal Reserve System shall from time to time limit by regulation the rate of interest which may be paid by member banks on time and savings deposits, and shall prescribe different rates for such payment on time and savings deposits having different maturities, or subject to different conditions respecting withdrawal or repayment, or subject to different conditions by reason of different locations, or according to the varying discount rates of

member banks in the several Federal Reserve districts. No member bank shall pay any time deposit before its maturity except upon such conditions and in accordance with such rules and regulations as may be prescribed by the said Board, or waive any requirement of notice before payment of any savings deposit except as to all savings deposits having the same requirement: Provided, That the provisions of this paragraph shall not apply to any deposit which is payable only at an office of a member bank located outside of the States of the United States and the District of Columbia. During the period commencing on Tthe effective date of this sentence and ending upon the expiration of three years after such date, October 15, 1962, and ending on October 15, 1968, the provisions of this paragraph shall not apply to the rate of interest which may be paid by member banks on time deposits of foreign governments, monetary and financial authorities of foreign governments when acting as such, or international financial institution of which the United States is a member.

(g) The Board of Directors shall be regulation prohibit the payment of interest on demand deposits in insured nonmember banks and for such purpose it may define the term "demand deposits"; but such exceptions from this prohibition shall be made as are now or may hereafter be prescribed with respect to deposits payable on demand in member banks by section 19 of the Federal Reserve Act, as amended, or by regulation of the Board of Governors of the Federal Reserve System. The Board of Directors shall from time to time limit by regulation the rates of interest or dividends which may be paid by insured nonmember banks on time and savings deposits, but such regulations shall be consistent with the contractual obligations of such banks to their depositors. For the purpose of fixing such rates of interest or dividends, the Board of Directors shall by regulation prescribe different rates for such payment on time and savings deposits having different maturities, or subject to different conditions respecting withdrawal or repayment, or subject to different conditions by reason of different locations, or according to the varying discount rates of member banks in the several Federal Reserve districts. The Board of Directors shall by regulation define what constitutes time and savings deposits in an insured nonmember bank. Such regulations shall prohibit any insured nonmember bank from paying any time deposit before its maturity except upon such conditions and in accordance with such rules and regulations as may be prescribed by the Board of Directors, and from waiving any requirement of notice before payment of any savings deposit except as to all savings deposits having the same requirement. For each violation of any provision of this subsection or any lawful provision of such regulations relating to the payment of interest or dividends on deposits or to withdrawal of deposits, the offending bank shall be subject to a penalty of not more than \$100, which the Corporation may recover for its use. During the period commencing on Tthe effective date of this sentence and ending upon the expiration of three years after such date, October 15, 1962, and ending on October 15, 1968, the provisions of this subsection shall not apply to the rate of interest which may be paid by insured nonmember banks on time deposits of foreign governments, monetary and financial authorities of foreign governments when acting as such, or international financial institutions of which the United States is a member.

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